

## US CARES Act has corporate implications, including NOL deductions, Section 163(j) interest expense limitation and AMT acceleration

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Enacted in response to the COVID-19 pandemic, the United States (US) *Coronavirus Aid, Relief, and Economic Security (CARES) Act* provides roughly US\$2 trillion in economic relief to eligible businesses and individuals impacted by the novel coronavirus outbreak. The CARES Act is significant legislation that will affect nearly every aspect of the economy.

This Alert discusses key provisions of the CARES Act affecting corporate taxpayers, including corporations seeking sources of liquidity through net operating loss (NOL) carryback claims and income tax refunds, as well as those seeking to understand how the CARES Act will affect mergers and acquisitions.

Taxpayers will need to carefully consider the interaction of various amended Internal Revenue Code (IRC)<sup>1</sup> provisions and may need to engage in financial modelling to determine the best use of tax attributes, such as NOLs, during the limited periods in which these taxpayer-favorable changes are in place. In addition, taxpayers should evaluate restructuring opportunities that may permit them greater utilization of certain tax attributes. The remainder of this Alert will discuss in more detail the following taxpayer-favorable amendments to the IRC made by the CARES Act:

- ▶ NOL deductions
- ▶ Expanded business interest expense deductions (Section 163(j))
- ▶ Alternative minimum tax (AMT) acceleration

## NOLs and NOL carrybacks

Under the CARES Act, NOLs arising in tax years beginning after 31 December 2017, and before 1 January 2021 (e.g., NOLs incurred in 2018, 2019, or 2020 by a calendar-year taxpayer) may be carried back to each of the five tax years preceding the tax year of such loss. Since the enactment of the *Tax Cuts and Jobs Act of 2017* (TCJA), NOLs generally could not be carried back but could be carried forward indefinitely. Further, the TCJA limited NOL absorption to 80% of taxable income. The CARES Act temporarily removes the 80% limitation, reinstating it for tax years beginning after 2020. Special carryback rules are provided for taxpayers such as real estate investment trusts (REITs) and life insurance companies.

As a result of changes under the CARES Act, corporate taxpayers with eligible NOLs may now be able to claim a refund for tax returns from prior tax years. As the CARES Act did not modify Section 172(b)(3), a taxpayer, where advantageous, can still waive the carryback and elect to carry NOLs *forward* to subsequent tax years. Further, in eligible tax years, corporate taxpayers may use NOLs to fully offset taxable income, rather than 80% of taxable income.

Many taxpayers – particularly multinational corporate groups that own controlled foreign corporations (CFCs) – will need to carefully consider the interaction of an NOL carryback with other IRC provisions. For example, a taxpayer that elects to apply an NOL carryback to a tax year in which the Section 965 transition tax was imposed will generally be precluded from taking its Section 965 inclusion when determining the amount of taxable income that may be offset by NOL carrybacks. The CARES Act does not, however, generally prohibit taxpayers from using an NOL from a tax year with a lower corporate tax rate (e.g., 2020) to offset taxable income that was subject to a higher corporate tax rate in an earlier tax year (e.g., 2017).

Moreover, before claiming an NOL carryback for a prior tax, corporate taxpayers may also want to consider how other tax attributes (e.g., foreign tax credits) that were absorbed in a prior year may now be displaced as a result of the carryback. Other considerations include the impact on the taxpayer's AMT liability, if any, in the carryback year.

Consolidated return groups will need to consider the computation and availability of consolidated NOLs, the allocation of that NOL to a departing consolidated return member and the group's utilization of a member's separate

return loss year NOL. Taxpayers that were party to an M&A transaction may also need to consider contractual limitations affecting their ability to carry back, or carry over, an NOL.

## Business interest deductions

The CARES Act modifies Section 163(j), which affects many types of businesses, including corporations, and was substantially modified by the TCJA in 2017. Section 163(j) limits the amount of business interest expense that may be deducted in a tax year to the sum of: (1) the taxpayer's business interest income for the year; (2) 30% of the taxpayer's adjusted taxable income (ATI) for the year; and (3) the taxpayer's floor plan financing interest expense for the year. For the years in question, ATI may be roughly analogized to the financial concept of earnings before interest, taxes, depreciation and amortization (EBITDA). The CARES Act changes the ATI limitation, increasing it from 30% to 50%, but only for tax years that begin in 2019 or 2020. An election contemplated by the legislation would permit a taxpayer to opt out of the 50% limitation. Moreover, another special election permits a taxpayer to use its 2019 ATI in lieu of 2020 ATI, with a pro-rata mechanism for short tax years.

Thus, corporations that otherwise would have disallowed business interest expense (the amount in excess of 30% of ATI, up to 50%) may be able to deduct more business interest expense in 2019 and 2020. Also, given a possible economic downturn in 2020, many taxpayers could have greater ATI in 2019 than 2020; in that case, the election to use 2019 ATI in lieu of 2020 ATI generally allows more interest expense to be deducted in 2020 than otherwise would be permitted. Of course, the additional interest expense that may be deducted may give rise to, or increase, an NOL, which, as previously discussed, may now be carried back to offset the taxable income of five prior tax years.

## Acceleration of minimum tax credit

The TCJA repealed the corporate AMT and allowed corporations to fully offset regular tax liability with AMT credits. Any remaining AMT credit amount became refundable incrementally from 2018 through 2021. The CARES Act accelerates the refund schedule, permitting corporate taxpayers to claim the refund in full in either 2018 or 2019. Taxpayers wishing to accelerate an AMT credit refund for 2018 may use a quick refund procedure (e.g., Form 1139) to claim these credits.

## Implications

While the CARES Act may not amend as many corporate IRC provisions as the TCJA, it will nevertheless have a significant near-term impact on corporate tax-planning. Two points from the prior discussion should be emphasized in this regard, reflecting the somewhat conflicting goals of caution and speed.

First, while this legislation is clearly designed to be taxpayer-favorable and is likely to improve the near-term cash flow of many corporate taxpayers, the decision to pursue a refund through an NOL carryback should be carefully considered for all of its knock-on effects, such as the effect on AMT liability in a carryback year (particularly when some or all of an associated AMT credit may have been recovered in subsequent years). Similarly, multinational groups with CFCs should be particularly mindful in considering the panoply of other Code provisions – many of which were enacted with the TCJA – that interact with an NOL deduction and could be affected by wholesale carryback decisions. Taxpayer profiles

vary – for some, the modelling exercise and corresponding refund decision will be relatively straightforward, but many corporate taxpayers will benefit from more thorough, nuanced, quantitative decision-making.

A competing consideration to emphasize is the relatively limited window within which to act. The most significant IRC changes previously discussed are not permanent; e.g., the relaxed rules on NOL carrybacks and the elimination of the 80% taxable limitation for NOL absorption apply for only three tax years, two of which have already passed (for calendar-year taxpayers). Meanwhile certain elective mechanisms must be exercised within a relatively short window (e.g., within 120 days of the CARE Act's 27 March 2020 enactment date).

Most corporate taxpayers will find the modest IRC changes made by the CARES Act to be quite helpful. The Code's complexity, however, requires most corporate taxpayers to consider the overall impact on their tax profile carefully before taking advantage of the CARE Act's changes.

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## Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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